MainStay MacKay Tax Free Bond Fund Class I MTBIX

Analysis

A bold expression of this team's highest-conviction ideas.
By Alaina Bompiedi 9/12/2018

Six experienced portfolio managers take a uniquely tactical approach at the helm of MainStay MacKay Tax Free Bond, which often courts concentrated positions in the group's highest-conviction ideas. While the team has demonstrated skill over its tenure, the uncertainty posed by its intrepid profile and its relatively lean analyst bench support a Morningstar Analyst Rating of Bronze.

Co-CIOs Bob DiMella and John Loffredo oversee the fund and are supported by a close-knit group of comanagers and a five-person analyst bench. All of the managers have working relationships with each other dating back to their time at Merrill Lynch Investment Management in the 1990s. Here, they take a valuation-driven and macro-minded approach that at times leads this portfolio to look quite different from its peers in the muni-national long Morningstar Category. In June 2018, the fund's outsize exposure to Puerto Rico and Chicago bonds (7.6% and 9.0%, respectively--significantly higher than the category average) were almost entirely wrapped by insurance. The fund's overweight to longer-maturity bonds was also hedged with U.S. Treasury futures. Both positions reflected the team's belief that insurance-wrapped bonds and long-dated munis would outperform through the end of the year.

The fund's preference for insurance-wrapped bonds doesn't insulate it from the headline risk associated with controversial underlying credits. The fund's insured Puerto Rico holdings sold off briefly when hurricanes Irma and Maria struck the island in the fall of 2017 but have since recovered. While this approach may cause short-term volatility, the team's valuation-mindedness has worked well over the long term. Since the team took over in July 2009, the fund's returns, on an absolute and volatility-adjusted basis, placed in the best quartile of its peer group.

The fund's fee structure hasn't changed over the past year, but it is now less competitive versus its peers, leading to a Price Pillar rating downgrade to Neutral. Still, this fund's distinctive approach could reward patient investors who are comfortable with its risks.

Process Pillar: Positive

This team uses top-down and bottom-up analysis in its search for relative value opportunities. A broad market outlook, which the team formulates every January, informs the fund's sector, state, and yield-curve positioning. From there, the team's bottom-up research process vets each individual bond, with particular attention paid to valuations.

The fund tends to have a higher-quality profile than the category norm, as evidenced by its relatively low exposure to midgrade and nonrated bonds and its typically below-average SEC yield. The team has focused on insurance-wrapped fare over the past few years, which allows it to access lower-quality underlying issuers that typically pay higher coupons. The team avoids making big relative bets on duration, keeping the fund's average duration to within 10% of that of its Bloomberg Barclays Municipal Bond Index benchmark.

A closer look at the portfolio shows that the team does court some credit and interest-rate risk, however. The fund's insurance-wrapped Puerto Rico bonds have been a big presence here since 2013, for instance, and the fund makes heavy use of a short position in U.S. Treasury futures to hedge its long-dated bonds, courting basis risk between the Treasury and muni markets. So far, the team has exercised sound judgment in managing these risks, though, supporting a Process Pillar of Positive.

An investment-grade-at-purchase mandate means the portfolio's credit quality tends to be higher than the typical category peer's. As of mid-2018, 88% of the fund's holdings were rated AAA to A,

Morningstar's Take

Morningstar Analyst Rating	Bronze

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Neutral
Price	Neutral

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

Gold Silver Bronze Neutral Negative

Fund Performance

	Total Return %	+/- Category
YTD	0.64	-0.16
2018	1.75	1.47
2017	5.77	0.06
2016	0.70	0.69
2015	4.21	1.14

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which was 10 percentage points higher than the category norm. The fund also held merely 0.6% of exposure to nonrated bonds, compared with 4.0% for the typical peer.

The fund's duration is kept close to the Bloomberg Barclays Municipal Bond Index's and stood at about six years as of June 2018. To allow the fund to emphasize higher-coupon long-maturity bonds while staying duration-neutral, the team has employed a sizable Treasury hedge to shorten the fund’s duration, a tactic that courts basis risk. As of June 2018, the fund held close to a 30% stake in 10- and 30-year Treasury futures, but the team planned to take this down should municipal/Treasury yield ratios richen.

A defining characteristic of the portfolio over the past few years has been its insurance-wrapped holdings, which have allowed the fund to access lower-quality names without cutting into the fund's overall credit quality. These included hefty stakes in Puerto Rico and Illinois bonds, which constituted just over a fifth of the portfolio as of June 2018. While nearly all of that debt was insured, this was nonetheless a concentrated exposure to potentially volatile names.

Performance Pillar: Positive

The managers aim to outperform two thirds of peers in the muni-national long category. While they have not met this goal every year, the fund's 5.7% annualized return from July 2009 through August 2018 placed it in the best quartile of distinct category peers. Its bias toward longer maturities and its select exposure to insured lower-quality names have helped its performance over the past three years, as credit spreads narrowed and the municipal yield curve flattened. Yet that same appetite for interest-rate and credit risk has weighed on performance during periods of market stress, such as 2013's taper tantrum. But bouts of volatility haven't sullied the fund's strong long-term record, supporting a Positive Performance Pillar rating.

The fund has access to various sources of return, including security selection, sector positioning, and yield-curve positioning. While most of these factors have been additive over the trailing three years, select trades have been significant drivers of performance. In 2017, the fund's Treasury futures hedge was a significant contributor that fared well as the municipal yield curve flattened. The fund's insured Puerto Rico bonds, meanwhile, detracted in the weeks immediately following hurricanes Maria and Irma. The fund ended the year lagging 60% of its category rivals.

People Pillar: Positive

Comanagers Bob DiMella and John Loffredo have worked together for more than two decades. They joined Merrill Lynch Investment Management's municipal-bond team in 1993 and remained with the firm through BlackRock's acquisition in 2006 until they started their own firm (Mariner Municipal Managers) in 2007. In 2009, MainStay hired the team to run its muni-bond platform at MacKay Shields. The team's other four portfolio managers--Mike Petty, David Dowden, Scott Sprauer, and Frances Lewis--all made the transition from MLIM to MacKay Shields. The team's long working relationship and experience earn a Positive People Pillar rating.

Loffredo oversees top-down positioning, while the other five managers contribute specific credit specializations. Lewis manages the five-person analyst team, whose experience ranges from one to six years. The analysts provide credit research but are also expected to provide input on valuations and have the authority to initiate buy and sell calls. Trader John Lawlor and risk analyst Joanna Ng round out the team, and all contribute to the group's annual market outlook.

This group manages four additional muni strategies for MainStay--California Tax Free Opportunities MCOIX, New York Tax Free Opportunities MNOAX, High Yield Municipal Bond MMHIX, and Short Term Municipal MSTIX--which similarly take a duration-neutral stance and emphasize the team's broad-market themes.

Parent Pillar: Neutral

MainStay is the retail investment brand of New York Life Investment Management, itself the asset-management arm of insurance company New York Life. MainStay's expansive mutual fund lineup is managed by NYLIM's investment professionals and subsidiaries, including fixed-income specialist MacKay Shields, global equity shop Candriam, Australian equity group Ausbil, and more recently, U.S. exchange-traded fund specialist IndexIQ. NYLIM also uses subadvisors, such as Epoch and Winslow, the latter of which runs MainStay's largest offering, MainStay Large Cap Growth. NYLIM has grown mostly through acquisitions and distribution partnerships.

NYLIM's boutiques tout that the parent allows them to operate with autonomy. In 2017, MacKay Shields Municipal Managers--one of the stronger boutiques under the NYLIM umbrella--was able to open a second office in Los Angeles to serve its growing base of California clients.

Yet, NYLIM's track record as a parent has some blemishes. The firm acquired long-short equity manager Marketfield in 2012, whose flagship fund, MainStay Marketfield, swelled to over $20 billion in assets by 2014, partly because of a strong sales push from MainStay. Asset bloat impeded performance, and the firms ended their relationship in early 2016. And while NYLIM grants its boutiques some independence, it merged Cornerstone into MacKay Shields in 2018. Overall, MainStay earns a Neutral Parent rating.

Price Pillar: Neutral

Most of the fund's assets are held in its A and I share classes, whose fees are about average compared with their respective distribution groups. In 2018, fees on both share classes (0.81% for the A shares and 0.56% for the I shares, excluding certain investment-related costs) were the same as their 2017 levels. The category got cheaper, however, making the fund's fees less competitive. Average fees overall bring the fund’s Price Pillar rating to Neutral from Positive.

NEW YORK LIFE INVESTMENTS

MainStay MacKay Tax Free Bond Fund — Class A and Class I Shares

Standardized Performance (Period ended 12/31/18)

Symbol (Inception)	1 year	3 years	5 years	10 years	Since Inception[1]
Class A (NAV) MTBAX (1/3/95)	1.50%	2.49%	4.69%	5.67%	5.12%
Class A (max 4.5% load) MTBAX (1/3/95)	-3.07	0.93	3.73	5.19	4.97
Class I (no load) MTBIX (12/21/09)	1.75	2.71	4.95	5.92	5.18

Total annual operating expenses are: Class A: 0.81% and Class I: 0.56%.

Returns represent past performance which is no guarantee of future results. Current performance may be lower or higher. Investment return and principal value will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Performance reflects a contractual fee waiver and/or expense limitation agreement in effect through 2/28/19, without which total returns may have been lower. This agreement renews automatically for one-year terms unless written notice is provided prior to the start of the next term or upon approval of the Board. Visit mainstayinvestments.com for the most recent month-end performance.

Standard & Poor's rates borrowers on a scale from AAA to D. AAA through BBB represent investment grade, while BB through D represent non-investment grade.

Bloomberg Barclays Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. An investment cannot be made directly into an index. Past performance is no guarantee of future results.

Duration, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates.

Taper tantrum refers to the 2013 surge in U.S. Treasury yields, due to the Federal Reserve's use of tapering to gradually reduce the amount of money it was putting into the economy.

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Morningstar Analyst Rating Spectrum: *Gold:* Best-of-breed fund that distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. *Silver:* Fund with notable advantages across several, but perhaps not all, of the five pillars—strengths that give the analysts a high level of conviction. *Bronze:* Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating. *Neutral:* Fund that isn't likely to deliver standout returns but also isn't likely to significantly underperform, according to the analysts. *Negative:* Fund that has at least one flaw likely to significantly hamper future performance and that is considered by analysts an inferior offering to its peers.

Before You Invest:

Before considering an investment in the Fund, you should understand that you could lose money.

A portion of the Fund's income may be subject to state and local taxes or the alternative minimum tax. The Fund may invest in derivatives, which may increase the volatility of the Fund's NAV and may result in a loss to the Fund. Funds that invest in bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner. Municipal bond risks include the ability of the issuer to repay the obligation, the relative lack of information about certain issuers, and the possibility of future tax and legislative changes, which could affect the market for and value of municipal securities.

1. Average annual total returns include the change in share price and reinvestment of dividends and capital gain distributions. Performance for Class A and I shares includes the historical performance of Class B shares from inception (5/1/86) through 12/31/94 for Class A and through 12/20/09 for Class I adjusted to reflect the applicable sales charge and fees and expenses. Class I shares are generally only available to corporate and institutional investors.

For more information about MainStay Funds®, call 800-624-6782 for a prospectus or summary prospectus. Investors are asked to consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus or summary prospectus contains this and other information about the investment company. Please read the prospectus or summary prospectus carefully before investing.

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